HOUSING MARKET INFORMATION

HOUSING MARKET ASSESSMENT

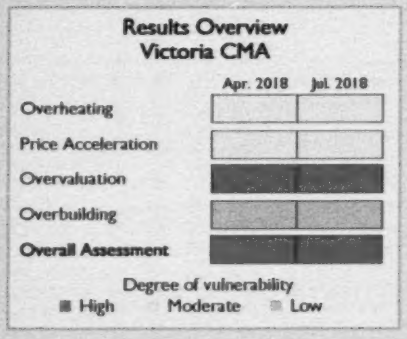
Victoria CMA

Date Released: Third Quarter 2018

Canada

CMHC SCHL

Highlights



- The HMA framework detected a high degree of housing market vulnerability in Metro Victoria[1].
- Supply remains low in Metro Victoria, but there is a growing inventory of new homes.
- The low inventory in the resale home market began to trend higher, improving selection for home buyers.
- Price growth slowed in the first half of 2018.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's Market Analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects degrees of vulnerability in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolve an excess supply imbalance by supporting stronger demand and/or reducing supply. However, other unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance.

Colour codes indicate the degree of market vulnerability. The HMA is a comprehensive framework that considers both the intensity of signals of imbalances (that is, how far the indicator is from its historical average) and the persistence over time. Generally, low intensity and persistence are associated with low evidence of vulnerability. As the number of intense and persistent signals increases, the associated degree of vulnerability becomes stronger.

In Detail

Overheating

There was moderate evidence of overheating in the first quarter of 2018. The sales-to-new-listings ratio (SNLR) was 71%, below the threshold of 80%. However, the rating is maintained when the SNLR exceeds its threshold for at least 2 quarters in the past 3 years.

As of June 2018, sales are down across all product types and are trending lower. However, new listings are also down, obscuring the interpretation of the SNLR to some degree. Furthermore, other indicators point to a market trending away from overheating. Active listings increased across product types with fewer sales. Days on market have increased, and fewer

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[1] Results are based on data as of the end of March 2018 and local market intelligence up to the end of June 2018. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

homes are selling above asking price. Nonetheless, inventories remain low, and while price appreciation has been above inflation, it simply is not as strong as in prior quarters.

Price Acceleration

Moderate evidence of price acceleration was detected in Metro Victoria for the eighth consecutive quarter. The test for price acceleration did not exceed the critical threshold; however, once detected, the rating will remain for three years. In Figure 2, the price acceleration indicator shows that price growth receded below threshold in the second quarter of 2017, marking the first full year since the acceleration indicator crossed threshold. Average MLS® price growth slowed to single digit year-over-year growth at 9% in the first quarter of 2019.

Braden Batch
Senior Analyst, Economics

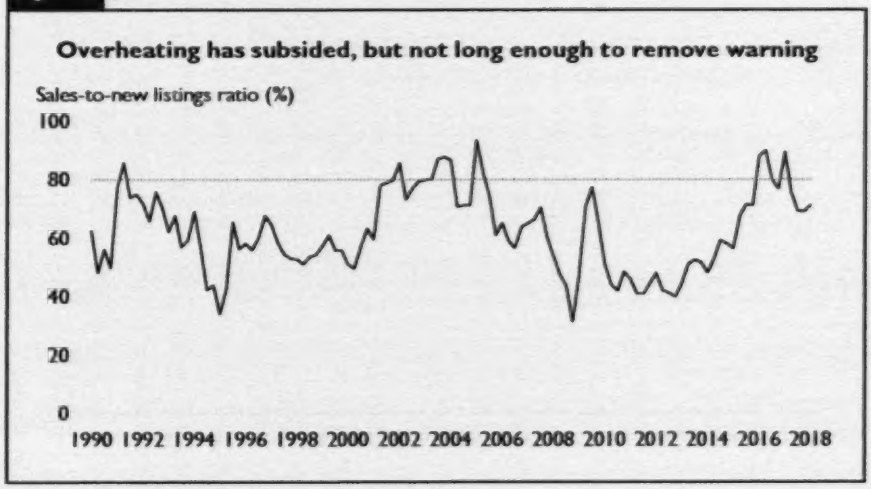
"A high degree of vulnerability was detected for the Metro Victoria housing market. A rapid decline in sales has allowed a modest build-up of inventory, dampening price growth. Inventory growth has been dominated by single-detached housing units at the higher end of the market. At the same time, overvaluation remains a concern largely driven by affordability."

Overvaluation

The HMA framework detected high evidence of overvaluation in Metro Victoria for the fifth consecutive quarter. Figure 3 shows that the average of all overvaluation models fell below threshold while the model with the strongest signal remained above. The high evidence of overvaluation rating was maintained as the average of overvaluation models was tri[illegible]d for at least two quarters in the previous year.

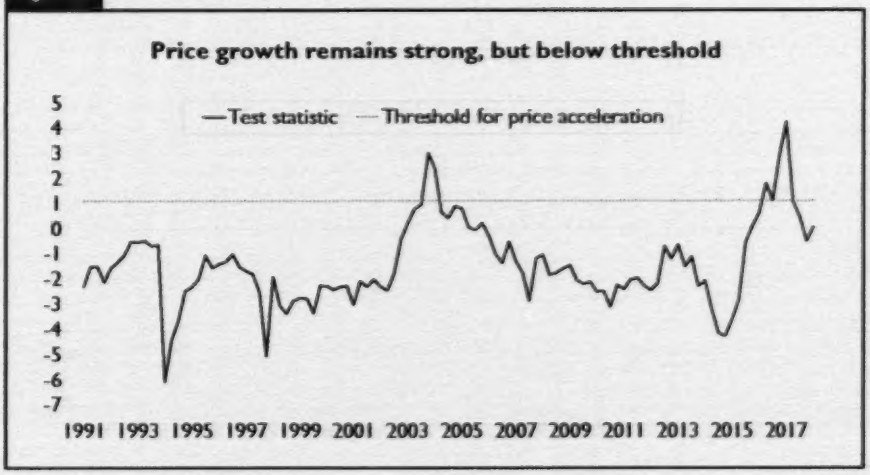
In the first quarter of 2018, models that detected overvaluation included a calculation of the carrying cost, explicitly, which is a key determinant for affordability. While recent increases to the interest rate have negatively impacted affordability, other demand fundamentals supported growth in house prices. The young adult population grew faster than the general population and real disposable income increased. Models that do not contain a

Figure 1



Source: CREA, calculations (threshold) by CMHC
Last data point: 2018Q1

Figure 2



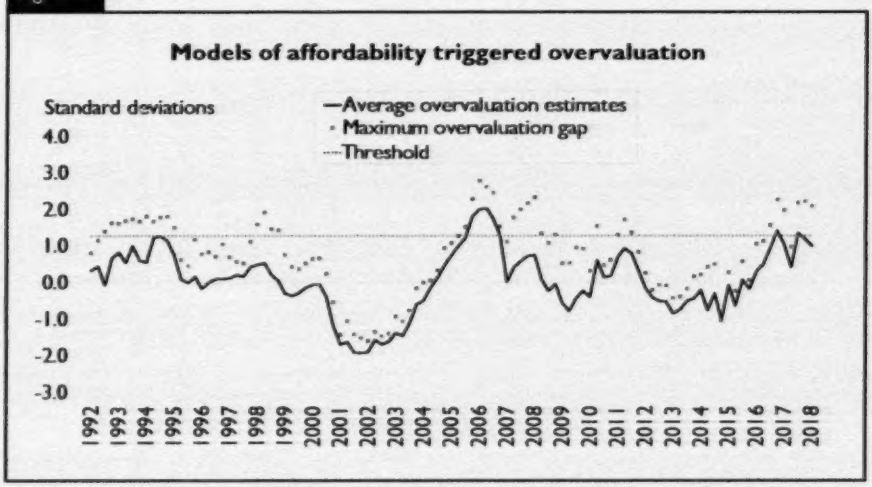
Source: CREA, CMHC calculations
Last data point: 2018Q1

carrying cost term, but utilize only demand and supply fundamentals like employment and population growth, have not indicated overvaluation in Metro Victoria.

Overbuilding

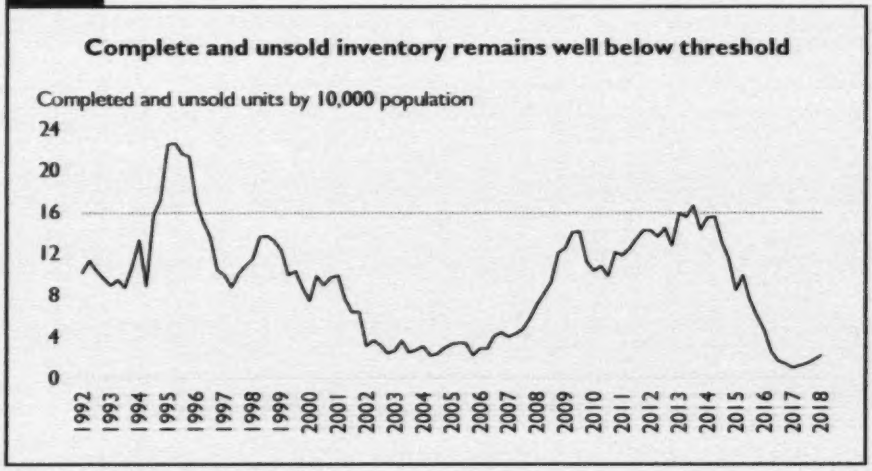
The HMA framework detected low evidence of overbuilding in the Metro Victoria housing market in the first quarter of 2018. Per capita complete and unsold units were well below threshold, yet inventory has trended up from a low point of 37 units in the first quarter of 2017. Single detached units dominated total inventory and now sit slightly below the 15 year average level in absolute terms. For condo apartments, units absorbed at completion declined to 86% in May, likewise mirroring reduced apartment sales in the existing home market. Since current condo construction remains elevated, inventory could begin to rise rapidly if the absorption share continues to decline. The apartment vacancy rate was 0.7% in the most recent rental market survey, while the threshold for overbuilding is set at 3%. As such, Metro Victoria was found to have low supply rather than overbuilding.

Figure 3



Sources: CREA, Statistics Canada and calculations by CMHC. Last data point: 2018Q1
Note: The average estimate of overvaluation is the average gap between actual house prices and price levels estimated from a group of selected models. Baseline models include demand, supply, hybrid, and affordability models, each of which is estimated using four measures of house prices to generate sixteen unique estimates of overvaluation. The selection of models is conducted with a set of cointegration tests, and the selected models are estimated with Dynamic Ordinary Least Squares (DOLS). The maximum overvaluation gap is obtained from the model that has the largest gap between the actual price and the estimated price. The threshold is fixed at a critical value of 1.29 for a confidence level of 80%. Overvaluation is signaled when overvaluation estimates lie above the threshold

Figure 4



Source: Statistics Canada and CMHC
Last data point: 2018Q1

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (1) overheating (when demand outpaces supply); (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding (when the inventory of available housing units is elevated).

For each factor, the framework tests for: (1) the incidence of signs of vulnerability, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify signs of overheating, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers. The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed. To assess signs of overbuilding in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators that can identify imbalances. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators showing vulnerability from the previous assessment.

* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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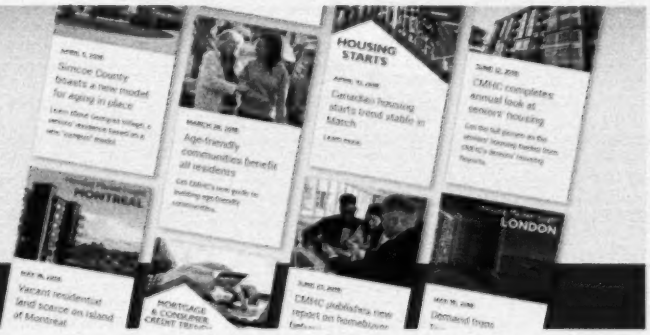

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